

Message Text

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ACTION EUR-12

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FM AMEMBASSY LISBON
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AMEMBASSY LONDON
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SUBJ: IMPORTANT GOP ECONOMIC MEASURES: COMMENTARY

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1. WIDE RANGING MEASURES REPORTED REFTEL ARE RATHER IMPRESSIVE
INDICATION THAT GOP HAS DEFINITELY DECIDED TO IMPLEMENT MEAN-
INGFUL ECONOMIC REFORMS IMMEDIATELY. ESCUDO DEVALUATION WAS
UNDOUBTEDLY THE MOST DIFFICULT AND SENSITIVE DECISION. GOP
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UNDOUBTEDLY FEARS SOME SHORT-TERM LOSS OF POLITICAL SUPPORT
BECAUSE OF ANNOUNCED MEASURES, BUT HAS SOUGHT TO LIMIT
THIS LOSS BY HOLDING PRIOR CONSULTATIONS WITH THE PRESIDENT,
OPPOSITION PARTIES, LABOR LEADERS, AND THE COUNCIL OF THE REV-
OLUTION. IN ADDITION, IT CAREFULLY INCLUDED SEVERAL
APPEALING MEASURES (HEALTH IMPROVEMENTS, PENSION INCREASES,
FIXED PRICES FOR CONSUMER NECESSITIES) TO HELP OFFSET

NEGATIVE IMPACT OF AUSTERITY MEASURES. SOCIALIST PARTY LEADERS HOPE, MOREOVER, THAT ECONOMIC RECOVERY WILL ENABLE THEM TO REGAIN WHATEVER SHORT-TERM LOSS OF POLITICAL SUPPORT THEIR DECISIONS MAY GENERATE. IN ANY CASE, GOP APPARENTLY REALIZES THAT CONTINUED DELAY IN IMPLEMENTING ECONOMIC REFORMS WOULD CERTAINLY COST IT AN UNACCEPTABLY HIGH POLITICAL PRICE OVER THE MEDIUM AND LONGER TERM.

2. FULL IMPACT OF MEASURES CANNOT BE GAUGED UNTIL GOP PUBLISHES COMPLETE TEXTS OF MEASURES ANNOUNCED EARLY FEB 26, AND THE NATIONAL ASSEMBLY ACTS ON PROPOSALS SUBMITTED TO IT. GOP EVIDENTLY SOUGHT, HOWEVER, TO HAVE PRINCIPAL IMPACT ON BALANCE OF PAYMENTS AND ON INVESTMENTS, INCLUDING THE PRIVATE SECTOR. DECISIONS TO DEVALUE, TO RAISE SALES TAXES, TO EASE PRICE CONTROLS, AND TO CURB IMPORTS SHOULD REDUCE CONSUMPTION AND THE EXTERNAL DEFICIT. THEY IMPLY ALSO, OF COURSE, AN ACCELERATION OF DOMESTIC PRICE INCREASES. ALTHOUGH MOST COUNTRIES WILL LIKELY ACCEPT GOP DECISION AS NECESSARY AND POSITIVE, SOME MAY WELL CRITICIZE THE FURTHER RESTRICTIONS ON IMPORTS.

3. ATTEMPTS TO STIMULATE INVESTMENT ARE SOMEWHAT MORE INDIRECT AND COMPLEX. GOP EVIDENTLY SEEKING TO ESTABLISH GREATER CONTROL OVER THE CREDIT SYSTEM TO ATTRACT GREATER SAVINGS AND TO DEVOTE MORE FUNDS FOR INVESTMENT. THE PROPOSED REGULATIONS ALLOWING BANKS TO REQUIRE PRODUCTION AND PROFITABILITY TARGETS IN EXCHANGE FOR CREDITS IS POTENTIALLY AN EXTREMELY IMPORTANT STEP TOWARDS REDUCING CONSUMPTION. AUTHORIZATION FOR THE NATIONAL SAVINGS LIMITED OFFICIAL USE

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BANK TO USE ITS LIQUIDITY FOR REDISCOUNTING, COMBINED WITH SEVERAL OTHER OF THE NEWLY ANNOUNCED MEASURES, SHOULD SIGNIFICANTLY EASE CREDIT AVAILABILITY. IT REMAINS TO BE SEEN WHETHER THE PRIVATE SECTOR WILL TAKE ADVANTAGE OF THIS AVAILABILITY, I.E. WHETHER THE GOP HAS MANAGED TO ESTABLISH MODICUM OF PRIVATE SECTOR CONFIDENCE.

4. INDICATION THAT GOP PLANS SELL 15 BILLION ESCUDOS IN BONDS PAYING INTEREST RATES OF FOUR TO FOURTEEN PERCENT IS SOMEWHAT PUZZLING. IT SUGGESTS GOP MAY ISSUE SEVERAL BOND SERIES REFLECTING A MIXTURE OF ATTRACTIVE. THE GOVERNMENT MAY, FOR EXAMPLE, ISSUE ONE SERIES PAYING A RELATIVELY HIGH THOUGH FIXED INTEREST RATE, PURCHASERS OF SUCH BONDS MAY THEN BE PERMITTED TO BUY SPECIFIED AMOUNT OF A SECOND BOND ISSUE WHICH PAYS A RELATIVELY SMALL INTEREST RATE, BUT WHOSE VALUE IS INDEXED.

5. IN CONCLUSION, GOP MEASURES, EVEN DISCOUNTING PALLIATIVES ANNOUNCED SIMULTANEOUSLY, APPEAR TO BE A DEFINITE, FORCEFUL

FORWARD STEP. IF VIGOROUSLY ENFORCED, AND COMBINED WITH PREVIOUSLY PUBLISHED DECREE LIMITING WAGE INCREASES TO 15 PERCENT, THEY SHOULD SIGNIFICANTLY EASE PORTUGAL'S BALANCE OF PAYMENT PRESSURES AND ASSIST GOP IN ITS EFFORT TO HOLD EXTERNAL DEFICIT \$700,000,000 THIS YEAR. THEY ARE LIKELY, HOWEVER, TO RAISE SOCIAL TENSIONS AS THEY CUT INTO THE POPULATION'S CONSUMPTION LEVELS.
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